

What is a Spousal By-Pass Trust?

Typically, Spousal Bypass Trusts are used in conjunction with retirement planning vehicles to protect your pension death benefits from being liable to Inheritance Tax (IHT) on the death of your spouse or civil partner. A Spousal Bypass Trust allows you to instruct the Trustees to make agreed payments from the Trust Fund to your chosen beneficiaries. Spousal By-Pass Trusts are not limited to death-in-service benefits and can be used for any lump sum death benefit from different pension arrangements or lump sums from life insurance, but not critical illness cover, cash values or other lifetime benefits

When would you use a Spousal Bypass Trust?

If, upon your death, your estate is worth more than £325,000 (the Nil Rate Band (NRB), being the amount that you can give away free of IHT), it may be subject to IHT at 40%. In most cases, when pension death benefits are paid they are normally free of IHT as they are paid at the discretion of the Scheme Trustees to a spouse or civil partner. If, however, the death benefits are directly paid to your spouse or civil partner, it could create or worsen an IHT problem if the value of their assets is already close to or above the £325,000 IHT threshold.

By using a Spousal Bypass Trust and nominating the Trust as the beneficiary to receive all or part of the death benefits means that the money will not form part of your spouse's or civil partner's estate, and thus will not be included when calculating their own IHT liability.

The Trustees, who you choose, have the discretion to decide from the beneficiaries you have chosen to receive the lump sum death benefits. Whilst the Trustees are not bound by your nomination, they will almost always take your wishes into account unless there are good reasons not to, such as not to disqualify a disabled person from receiving State benefits or to prevent the proceeds from being taken into account for divorce settlements or bankruptcy proceedings.

Keeping control over a Spousal Bypass Trust

A Spousal Bypass Trust provides much flexibility and you can add or remove beneficiaries, change the terms of the Trust or change the Trustees as often as you wish. If, after you die, your beneficiaries need the money, the Trustees can provide loans (usually at zero interest) or make absolute payments to the beneficiaries. This means your spouse or civil partner could get a loan from the Trust Fund which they are free to spend as they choose. Even if they have spent the money, its value will be deducted from their estate at their death, thus reducing what if any IHT they would have to pay. Any money left in the Trust would then go to your other chosen beneficiaries such as children or grandchildren.

The Spousal By-Pass Trust and Tax

As a form of Discretionary Trust, a Spousal By-Pass Trust will still be subject to its own IHT regime; but careful planning and management can reduce or minimise the ten-yearly tax charge of 6% on the value of the Trust which exceeds the prevailing NRB and the 6% exit charge. However, whilst the Settlor is still alive, the sole Trust asset (the future right to the death benefit) has only nominal value and does not therefore exceed the NRB, meaning that no tax liability will arise from the ten-year charge. Moreover, if a ten-year anniversary falls within two years after the Settlor's death, there will be no charge for that anniversary, but thereafter the ten-year periods will continue to run as normal.

This fact sheet is based on our understanding of current taxation, legislation and HM Revenue & Customs practice as at February 2013, all of which are liable to change without notice. The impact of taxation (and any tax reliefs) will depend upon your individual circumstances.

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